Company's Interconnect Service Centers. These centers will be expanded to accommodate CLECs with their own loops, Local Interconnection Services ("LIS-Link"), Resellers and Rebundlers, (both mechanized and manual order taking), and customer inquiry, billing and collection services. Account codes, responsibility center codes, and expenditure type codes will be utilized to capture start-up costs related to this expansion. Start-up costs will primarily involve the establishment of these expanded services including the initial costs for workstations, furniture, office equipment, and training.

Network start-up costs include costs necessary to transform the current single provider network architecture into the new multiple provider network. The costs to transform the network can be considered as either direct or shared. Direct costs will be tracked through unique codes in U S WEST's Job Expenditure Tracking System (JETS). Costs for shared network facilities, such as inter-office facilities (IOF), will be developed as follows:

Example
(Hypothetical numbers)

(1) Actual "New" Statewide (IOF) investment, divided by $10,000,000

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(2) Actual "New" Statewide (IOF) usage, equals

1,000,000,000 MOU =

(3) Actual "New" investment $ per unit, multiplied by $ .01 /MOU x

(4) Actual "New" Statewide *interconnect* usage, equals 7,000,000 MOU =

(5) Actual "New" *interconnect* investment $ 70,000

Costs of interconnection for shared interoffice facilities will be identified through the use of CROSS7[3] technology. This equipment is the same equipment that will be used to determine transport charges for terminating usage. The interconnect costs of interoffice facilities required to reconfigure the network will be determined by the relative use of interconnection (as measured by CROSS7) compared to total usage over those facilities (as shown in the above example). Costs related to dedicated facilities will be subtracted from the total shared costs to eliminate potential double counting. Tandem switching costs will be tracked in a similar manner to shared interoffice facilities.

6. ICAM Recovery Method.

The extraordinary costs associated with interconnection, unbundling, resale and number portability should be recovered via the ICAM over three years. U S WEST will measure the actual interconnection, unbundling and resale costs incurred starting with the first quarter of 1997.

U S WEST proposes that the Commission establish a payment mechanism that will recover these extraordinary "start-up" costs over three years, subject to true-up after the three-year time period. While there may be other recovery options that the Commission could consider, U S WEST offers the following two options for the recovery of these costs:

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[3] CROSS7 is an adjunct to SS7 technology that will measure interconnection traffic.

- Option 1: Extraordinary costs are recovered via a quarterly surcharge assessed directly to CLECs.
- Option 2: Extraordinary costs are recovered via a monthly surcharge to all access lines provided by U S WEST and the CLECs.

Option 1 proposes to recover the extraordinary costs of interconnection, unbundling, resale and number portability from the CLECs, rather than U S WEST's end user customers. With this option, the costs for interconnection, unbundling, resale and number portability would be separately identified so that the appropriate costs would be assigned to the appropriate type of CLEC. For example, a pure reseller would only be allocated costs related to resale. A CLEC engaged in resale, interconnection and the purchase of unbundled network elements would be allocated costs for all four categories of cost. This approach would recover the costs from the cost causer.

Option 1 includes several sub-options as to how these costs can be recovered from CLECs. The simplest option would be to allocate the cost to all CLECs on an equivalent basis. That is, if resale costs were $1,000 and there were four resellers, each would be assessed $250. However, the Commission could also decide to spread the costs based on several other methods, as described in U S WEST's filing:

- The number of customers the CLEC serves;
- The number of access lines the CLEC serves;
- The revenue stream of the CLEC;
- The number of customers in the CLEC's defined service area.

The surcharge would be payable on a quarterly basis over the three-year transition period.

Option 2 would recover extraordinary interconnection, unbundling and resale costs via a monthly surcharge that would be assessed to all access lines served by the U S WEST network, whether the end user is served by U S WEST or CLECs. For U S WEST access lines, this charge would be levied on all lines that currently are assessed a federal end user common line (EUCL) charge. The ICAM surcharge would be the same for all classes of service and would not be discounted for resold access lines. Additionally, CLECs purchasing an unbundled local switching port or an unbundled loop would be charged the ICAM surcharge.[4] To be competitively neutral, the Commission should require CLECs to self report, on a quarterly basis, the number of access lines, and those lines should be assessed the ICAM surcharge, payable to U S WEST.

The Commission could consider proposals to implement a combination of options 1 and 2 or could develop an alternative option.

The majority of start-up costs are not included in the cost categories contained in long run incremental cost studies. However, it is not the Company's intent to propose a special recovery mechanism that recovers costs already recovered through other mechanisms. To the extent that certain costs are identified as recovered through other

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4 U S WEST advocates that a CLEC should not be allowed to purchase an unbundled loop along with an unbundled port, to recreate local exchange service (what we have referred to as "sham unbundling"). However, if the Commission allows this situation, then the ICAM surcharge should be billed only on the unbundled loop.

charges, the revenues from those charges will be considered in the ICAM process to assure no double recovery.

There are precedents for this type of special recovery. In numerous examples in the past, federal and state regulators recognized and provided special recovery mechanisms for extraordinary circumstances. These special recovery mechanisms were considered exceptions to possible prohibitions against "piecemeal" or "single-issue" rate making. Cost of fuel adjustments have been used for years in the area of power generation. In areas more germane to telephony, several states approved special recovery mechanisms for rural service upgrades and switching technology upgrades that were considered extraordinary, in the public interest, and not recovered in ordinary recurring rates. In federal regulation, the FCC ordered special accounting and amortizations for competition driven changes in customer premise equipment, inside wire, and the extraordinary costs associated with the network modifications required to provide equal access to interexchange carriers. All of these "single issue," extraordinary costs were recovered through special recovery mechanisms outside of rate cases and, therefore, are exceptions to "single-issue" ratemaking.

Currently, states are also allowing, or considering the allowance of, special recovery mechanisms for intraLATA equal access. As discussed earlier, Minnesota recently allowed a special recovery mechanism for those extraordinary costs in the EANR mechanism. In addition, special accounting and recovery is currently under consideration at the FCC for the competition driven extraordinary costs to provide permanent local number portability.

U S WEST proposes that categories of initial extraordinary costs be determined by the Commission, tracked on an actual as-incurred basis, and recovered through special rates over the period 1997 through 1999 with a true-up process continuing through this period and completing in 2000. U S WEST proposes that the accounting for these costs be available for audit on an annual basis.

U S WEST will account for the recovery of these capital costs as a charge to expense and a credit to its depreciation reserve. Revenues that represent the recovery of U S WEST's capital will be offset by depreciation expense in a like amount, thereby negating any affect on U S WEST's operating income. The amount charged as depreciation expense will be credited to the Company's depreciation reserve, thereby offsetting any impact after the three-year period on U S WEST's rate base. Revenues representing the recovery of expenses will negate the impact upon U S WEST's operating income.

7. ICAM True-Up Mechanism.

U S WEST proposes that it report actual accounting costs on a quarterly basis. The ICAM charge will be adjusted to reflect the level of expenditure for these costs, with a delay of approximately three months. This process would continue for three years. At the end of the three-year period, a final true-up would be made to complete the recovery of the costs. Since only the costs that were identified as appropriate would be tracked, recovery would be limited to these costs.

Such a true-up mechanism would work in the following manner. In the first quarter 1997, U S WEST will track what it believes are the costs appropriate for this

process. It will report to the Commission what it has expended in expense and capital during this period. When proceedings that determine the type and extent of costs that have been deemed appropriate for special recovery are complete, U S WEST will be allowed new revenues to recover these costs. This tracking, reporting and billing process would continue through the thirty-six month period under the proposal.

The costs, which will be tracked on a quarterly basis, could be adapted to various recovery and true-up schedules. The method proposed by U S WEST would start the recovery process with costs incurred through first quarter 1997. These amounts would be amortized over the next six-month period. Costs for second quarter 1997 would be amortized over the next six-month period, and so forth. This process would result in a rolling six-month amortization of the costs. Recovery methods could be set at quarterly, six-month intervals, or longer to attempt to match recovery with the cost.

Detailed records and reports will be created and maintained to allow annual audits of the accounting and the process. Audits by commission staffs or external auditors can be undertaken and adjustments, if any, can be included in the quarterly adjustments or the final true-up.

Specific planning has been included to facilitate auditing of the tracking process. Detailed records, calculations, and physical support for the transaction accounting will be created and maintained for review.

B. INDIVIDUAL RESPONSE TO COMMENTS OF VARIOUS PARTIES.

1. Response to the DPS and OAG.

In its comments, the DPS recommended that the Commission reject U S WEST's ICAM filing, because it believes all cost recovery issues have been referred to the generic cost proceeding. U S WEST disagrees with the DPS recommendation and will respond to several issues raised by the DPS.

The DPS and OAG argue that there is no basis for the ICAM filing because the issue of cost recovery has been, or will be, fully addressed in the arbitration proceedings and/or the generic cost proceeding. The DPS cites several passages in the December 2, 1996, Consolidated Arbitration Order to show that the Commission has already dealt with the cost recovery issues U S WEST has raised in ICAM, or that these issues will be addressed in the Generic Cost Proceeding. However, U S WEST does not agree, and believes that these proceedings did not, and will not address a significant portion of the extraordinary costs that will be incurred by U S WEST--costs that U S WEST has a right to recover.

It is important to distinguish between several different types of cost. In the ICAM proceeding, U S WEST seeks recovery of extraordinary "start-up" costs associated with implementing competitive mandates. These are costs that must be incurred now, to modify systems and to set up and reconfigure the network so that U S WEST can meet its obligation to serve CLECs. These are *not* the ongoing costs that would be recovered in the recurring and nonrecurring prices for interconnection services and unbundled network elements. These costs were not fully addressed in the arbitration

proceeding, and they will not be adequately addressed in the generic cost docket. Indeed, U S WEST described these costs in the arbitration hearings, and the Commission's Order states that it would welcome such a proceeding. Order at p. 65.

a. Special Construction Costs.

The DPS first notes that the Arbitration Order allows U S WEST to recover special construction costs.[5] However, these special construction costs are not the costs that U S WEST seeks to recover via ICAM. These special construction costs relate specifically to when U S WEST must construct facilities for a CLEC, so that the CLEC can resell U S WEST service.[6] For example, the order would require a CLEC to pay special construction charges if U S WEST constructed a loop for a CLEC, so that the CLEC could resell U S WEST service. These special construction costs are not included in ICAM–in fact ICAM identifies no extraordinary network costs associated with resale, but instead seeks the recovery of extraordinary interconnection, unbundling and number portability network costs.

b. Recurring Unbundling Costs.

The DPS notes that the Commission addressed the recovery of recurring costs for unbundled network elements in the arbitration proceeding, and will true-up these prices in the generic cost docket.[7] However, via ICAM, U S WEST is seeking the recovery of extraordinary start-up costs--not the ongoing costs associated with the

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5 DPS Comments, page 3.

6 Order resolving arbitration issues, Docket No. P-442, 421/M-96-855, et al., page 36.

7 DPS Comments, page 4.

provision of unbundled network elements. These costs were not part of the arbitration discussion regarding setting recurring prices--and would not be part of the recurring price true up process that would occur in the generic cost docket.

c. Nonrecurring Unbundling Costs.

The DPS and OAG note that the Commission addressed nonrecurring costs in the arbitration docket, but could not settle on a dollar amount for recovery. Therefore, nonrecurring prices would be set at zero for the interim and would be addressed in the generic cost proceeding. However, it is important to understand that the start-up costs that would be recovered via ICAM are not the same as nonrecurring costs. Nonrecurring costs are costs that U S WEST incurs when a customer orders service and are incurred over time. For example, a nonrecurring cost for the unbundled loop would be incurred each time an unbundled loop is ordered. Start-up costs, on the other hand, relate to the costs of preparing the network and systems to be able to provide unbundled loops. These are transitional costs that would not be included in a nonrecurring cost study for unbundled loops.

In addition, the conditioning of a loop is a type of nonrecurring cost. The Commission ruled that these costs may be recovered by U S WEST, based on costs. U S WEST proposes that the cost of conditioning loops (i.e., removing load coils and bridge taps) be recovered via a nonrecurring charge. This would be addressed in the generic cost proceeding. U S WEST does not propose recovering these costs via ICAM.

Therefore, the DPS is not correct to assume that since nonrecurring costs will be addressed in the generic cost proceeding, that start-up costs will be addressed in that docket.

d. Network Modification Costs.

The DPS states that the Arbitration Order provides for allocation of development or modification costs based on each party's share of the traffic. The Arbitration Order states that the Commission agrees with the reasons stated in the ALJ Panel's Report. The ALJs' decision provides:

> To the extent that existing facilities must be modified in order to establish a network of two-way trunks or other new capabilities, the parties who benefit shall share the costs in proportion to each party's traffic. Where a CLEC requests that a specific element be developed for its benefit, the requesting CLEC shall reimburse USWC for its development costs.

ALJ Panel Report at p. 63. Thus, this requires an analysis of who benefits from the required modifications. The full cost of all modifications over and above that which U S WEST would install to serve its own needs benefit the CLECs that use that network. The purpose of the ICAM filing is to recover network modifications that benefit CLECs. To the extent that network modification costs are not captured in the generic cost docket, they should be included in the ICAM mechanism.

e. Tandem Switching and Transport Costs.

The DPS observes that the arbitration order addresses the pricing of tandem switching and transport. The Commission order states that parties will pay tandem

switching and transport costs through usage sensitive TELRIC rates.[8] However, the Commission also ruled that mutual compensation rates would be symmetrical, and that CLEC switches would normally be considered to be equivalent to U S WEST's tandem switch.[9] Therefore, since CLECs and U S WEST would pay each other symmetrical rates, there would be a "net" of zero between carriers for transport and termination--despite the fact that U S WEST would incur substantially more costs, including extraordinary "start-up" investments, as noted earlier in these comments.

Thus, the Commission has not established any means for the recovery of U S WEST's extraordinary tandem switching and transport costs. While U S WEST will have to spend millions *now* to reconfigure its network, and add tandem and transport capacity to serve CLECs, there is no mechanism in place to recover the extraordinary investments that U S WEST must make *now* in Minnesota. Not only is there no mechanism to recover *now* the costs of investments that U S WEST must make *immediately*, but there is not even a recovery mechanism that will compensate U S WEST for these investments over time.

f. Operational Support Systems.

The DPS asserts that operational support systems were addressed by the Commission in the arbitration order, and that when U S WEST documents economically efficient costs, U S WEST can file proposed prices. However, per the Order, this applies specifically to interfaces--not the whole of systems. To facilitate competition,

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[8] Arbitration Order, page 74.

[9] Order resolving arbitration issues, Docket No. P-442, 421/m-96-855, et al., page 72.

U S WEST will incur extraordinary costs to modify systems, regardless of whether access to these systems is provided via an electronic interface. The Commission has not yet addressed these systems costs.

g. Summary.

The DPS concludes that all extraordinary costs that will be incurred by U S WEST have been addressed in the consolidated arbitration, or will be addressed in the generic cost docket. The DPS asserts that "U S WEST has not identified any cost recovery issue that has not already been addressed in the arbitration proceeding."[10] U S WEST disagrees. As demonstrated herein, there are significant extraordinary costs that U S WEST will incur to enable competition that have not been heretofore addressed. Via ICAM, U S WEST proposes to recover extraordinary costs that it must prudently incur to enable competition per the directives of the Telecommunications Act. These costs will not be recovered in any other manner. U S WEST is not seeking to "double recover" any costs.

It would be unfair to U S WEST for the Commission to reject this filing without further investigating its merit. The Commission cannot expect U S WEST to expend millions of dollars for the benefit of its competitors without providing any way for U S WEST to recover these costs. U S WEST does not believe that the generic cost proceeding, which will set recurring and nonrecurring prices, is likely to address these costs.

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[10] DPS Comments, page 5.

2. Response to AT&T, MCIm, MFS and Frontier.

The arguments of these parties are very similar, so U S WEST will address them generically.

a. Ability of U S WEST to Invest Absent a Cost Recovery Mechanism.

In its petition, U S WEST stated that if the Commission does not undertake expeditious treatment of the ICAM application, U S WEST reserves the right to re-evaluate the appropriateness of further expenditures, after notice to the Commission. AT&T, MCIm and Frontier each accuse U S WEST of a "threatening tone,"[11] of making a "thinly veiled"[12] or "brazen"[13] threat, and trying to "extort unwarranted cost recovery."[14]

U S WEST does not intend to threaten the Commission. As stated earlier, U S WEST will comply with the law. However, the Commission must understand that it is entirely unfair and confiscatory for U S WEST to be mandated by the government to incur costs for the benefit of its competitors, without a mechanism for the recovery of these costs. U S WEST should not be expected to continue to invest its limited capital for the benefit of CLECs without the expectation that these costs will be recovered as they are incurred.

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11 Frontier Comments, page 6.

12 MCIm Comments, page 4.

13 AT&T Comments, page 6.

14 AT&T Comments, page 6.

While these parties profess shock that U S WEST has asserted that governmental entities have no right to coerce uncompensated construction,[15] and that U S WEST might be forced to reevaluate its expenditure level based upon the allowed recovery vehicle, U S WEST submits that it is not a remarkable proposition that an American citizen could decline to perform uncompensated forced labor. While the issue of the government's authority to force a citizen to perform service is obviously a complicated one, the fundamental proposition that U S WEST will not work and make investments without compensation is neither exceptional nor radical. In the competitive marketplace, the government must be very careful when it chooses to load public burdens on selected industry players.

b. Extraordinary Costs are Incurred for the Benefit of CLECs.

A common theme in the comments of AT&T, MCIm and Frontier is that the extraordinary costs incurred by U S WEST to enable competition are not incurred for the benefit of CLECs, but for the benefit of all consumers. All three carriers, in lock step, provide the exact same comment, that "all end users--including U S WEST's customers--benefit from the interconnection between competing carriers."[16]

This statement is apparently made to support the CLECs' position that U S WEST should incur these extraordinary expenses "for the common good" without any expectation of recovery--or at least not recovery from CLECs. Thus, U S WEST is

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[15] MFS even makes the startling assertion that "LECs are not entitled to full and complete recovery of all network rearrangement costs . . . ." MFS Comments, page 5 (emphasis in original). MFS' intentions that U S WEST property be confiscated without just compensation are very clear.

[16] AT&T Comments, page 7, MCIm Comments, page 3, Frontier Comments, page 6.

apparently expected to fundamentally reshape its network and systems, at a significant cost, but should not be permitted to recover these costs, since "all end users benefit." The Commission should be clear on one point--that these extraordinary costs are caused by the onset of competition, and the requirement to serve the needs of CLECs. Absent the specific needs of CLECs, these costs would not be incurred. Further, U S WEST has a right to recover these costs.

AT&T, MCIm and Frontier also argue that each party should pay for its own implementation costs. For example, MCIm notes that new entrants will incur implementation costs, and that new entrants are not requesting U S WEST to reimburse them for these implementation costs.[17] This logic misses the mark. As the incumbent carrier, U S WEST has a ubiquitous public network in place, which new entrants will rely on for at least the immediate future. The government has required U S WEST to make modifications in this network and the related systems so that CLECs can access this ubiquitous network--modifications that would be unnecessary except to meet CLEC needs. These changes will directly benefit CLECs and their customers. While CLECs are also "implementing" their networks, these are a fundamentally different type of expenditure. While U S WEST is making investments, based on governmental mandate, that will directly benefit CLECs, CLECs are making investments, based on their own free will, to serve customers they choose to serve based on the potential for a return on their investment. These investments do not benefit U S WEST, and are not required by governmental mandate. In essence, AT&T,

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[17] MCIm Comments, page 3.

MCIm and Frontier would like U S WEST to make large investments for their benefit--without them having to pay for it.

c. Alleged Barriers to Entry.

AT&T, MFS and MCIm also claim that the ICAM mechanism represents a barrier to entry, in violation of Section 253(a) of the Telecommunications Act.[18] They claim that ICAM would require these CLECs to pay both their own implementation costs and U S WEST's implementation costs and that this represents a barrier to entry. This claim is without merit. As described above, there is a fundamental difference between U S WEST's mandated costs, incurred specifically for the benefit of CLECs, and a CLEC's discretionary costs. To recover from CLECs costs that are incurred to meet governmental mandates, for the express benefit of CLECs, hardly represents a barrier to entry.

This argument is nothing less than mouthing the word "competition" as a shibboleth without offering the slightest insight into what it actually means. Competition cannot possibly be advanced in any meaningful sense by the governmental expropriation of private property--be it the property of ILECs or others. Congress was very careful to spell this out in the Telecommunications Act. If CLECs really cannot flourish without extensive governmental subsidies, such as they demand, they are simply not capable of competing at all. The Telecommunications Act and the FCC's First Report and Order require that ILECs share with interconnectors certain economies of scale and scope which are residual from the days when ILECs possessed statutory

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[18] AT&T Comments, page 8; MCIm Comments, pages 3-4, MFS Comments, pages 2-3.

monopoly rights. Providing access to essential facilities is a long-standing requirement of the law.[19] While the First Report and Order goes well beyond standard antitrust and economic principles in establishing interconnection rights and obligations, it has not deviated from the fundamental principle that competitors must ultimately compete based on their own abilities, not based on their ability to pilfer facilities and services from ILECs. The idea that competition cannot flourish if competitors are actually required to pay for what they purchase is as foreign to economics as it is to the Telecommunications Act and the FCC's First Report and Order.

AT&T claims that the ICAM mechanism is "blatantly discriminatory" and "seeks to impose the financial burden of network adjustments entirely on new entrants."[20] AT&T argues that this violates federal law, and that any costs associated with competition should be shared proportionately among all local exchange carriers. First, the recovery from CLECs of extraordinary costs that are caused by CLECs is not a violation of law. Nowhere in the Act is such recovery prohibited.[21] Second, U S WEST has provided two options for ICAM recovery: (1) as a charge directly to CLECs, or (2)

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19 See United States v. Terminal R. Asso., 224 U.S. 383 (1912).

20 AT&T Comments, page 6.

21 In a recent filing before the FCC, three other CLECs allege that Section 252(d) of Act specifically precludes the recovery of extraordinary expenses associated with implementing competition. Incredibly, these parties argue that U S WEST is prohibited by this section of the Act from recovering these costs at all, and that this is somehow not confiscation. (See Petition for Declaratory Ruling and Contingent Petition for Preemption, February 20, 1997, filed by Electric Lightwave, Inc., McLeod USA Telecommunications Services, Inc. and Nextlink Communications, L.L.C., before the FCC) However, the Act clearly does not prohibit such recovery. This filing is indicative of a common CLEC theme--that U S WEST must comply with governmental competitive mandates that benefit CLECs, and must incur whatever extraordinary costs are necessary, but that CLECs should not have to pay one cent of this cost.

as a charge to all end users, including CLEC and U S WEST end users. If the Commission selects option 2, costs are allocated "proportionally" to U S WEST and CLEC customers. AT&T certainly cannot claim that this option is "blatantly discriminatory" and "lacks even the pretense of competitive neutrality."

U S WEST's dilemma is simple--how to fund extraordinary costs that it must incur now to enable competition. While U S WEST believes it is reasonable (and certainly legal) to assign these costs to CLECs, it is willing to accept a charge based on access lines, if the Commission so chooses.

d. ICAM Application is Not Contrary to Commission's Prior Orders.

AT&T claims that the ICAM filing is "an improper attempt to re-litigate issues raised and determined adversely to U S WEST in the Commission's decision in the recent arbitration with AT&T, MCIm and MFS."[22] This is not the case.

The ICAM filing addresses the recovery of costs that were not addressed in the arbitration proceeding and are not likely to be addressed in the generic cost docket. The extraordinary costs for which U S WEST seeks recovery via ICAM are fundamentally different than the costs addressed in the arbitration proceeding. While the arbitration proceeding (and the generic cost docket) address the ongoing recurring and nonrecurring costs of interconnection and unbundled network elements, along with resale discounts, these proceedings have not dealt with the extraordinary start up costs associated with implementing competition. Since these extraordinary costs were not

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22 AT&T Comments, page 4.

addressed in the arbitration proceeding, the U S WEST ICAM does not represent an attempt to re-litigate issues as claimed by AT&T.

AT&T claims that the Hatfield cost model, sponsored by AT&T and MCIm, somehow "fully addresses many, if not all of the costs U S WEST seeks to recover in its ICAM."[23] Based on this claim, AT&T argues that these costs were addressed in the arbitration proceeding. However, this claim is simply false because these extraordinary costs are very clearly not addressed in the Hatfield model, and, thus, any prices based on the Hatfield model would specifically not include any of these extraordinary start-up costs.

e. ICAM Is Not Inconsistent with State Law and Commission Rules Nor is the ICAM Filing An Improper Ratemaking.

AT&T argues that this filing should be viewed as a rate case under Minn. Stat. §237.075 and under Minn. Rules part 7829.2400, which governs filings requiring a determination of gross revenue requirement. AT&T's claim is simply another way of claiming that these costs must be dealt with in a rate case. As is described below, these costs are not suitable for rate case treatment. Moreover, these costs flow out of the obligations of an ILEC imposed by the Telecommunications Act. They are costs incurred to comply with the government's policy to introduce competition in the manner outlined in that statute. These costs must be recovered through charges separate from traditional ratemaking processes in precisely the same way as charges for unbundled elements are separate from traditional ratemaking processes.[24]

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[23] AT&T Comments, page 11.

[24] When the government forces anyone--be it U S WEST, CLECs, or an individual citizen--to

These expenditures will place a heavy burden on the financial operations and cash flow of U S WEST. The prices set by this Commission and, thus, the revenues and cash flows that U S WEST receives for its traditional services, were based upon operating conditions that existed during the historical regulatory test year and did not consider or contain expenditures of this nature or degree. Therefore, these expenditures should be considered "not-ordinary," or extraordinary. These expenditures are not comparable to on-going network improvements, upgrades, or other ordinary changes in business operations. The expenditures that the Company is requesting for special consideration are those government mandated costs to implement interconnection, unbundling, number portability, and resale. Most of the costs that are requested for consideration for special recovery are limited to costs that can be considered "start-up" costs. Another way of looking at these costs is to consider them as "transition" costs incurred to change local telecommunications from a primarily single local provider business to a multiple provider business.

Costs of this type require a special recovery mechanism for several reasons. First, U S WEST is legally obligated to provide interconnection capabilities for the new entrants. U S WEST must incur these costs because they are mandated under the Telecommunications Act and, in some cases, mandated through Commission decisions

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construct facilities for another, full compensation must be paid for that specific coerced action. Coerced construction cases are not the same as confiscatory ratemaking cases. When the Government seized the Youngstown Steel plant, it was no defense to the seizure that the plant might make a profit under its new owners. Youngstown Sheet & Tube Co. v. Sawyer, 72 S.Ct. 863 (1952). To the contrary, such government-forced action is much more akin to a physical seizure of property, and would constitute a *per se* taking requiring direct and tangible compensation.

and state law. Since U S WEST has no choice but to incur these costs, it is entitled to recovery of these costs. Second, it is plainly unfair to burden U S WEST and its retail customers with the large costs to fund the competitive mandates required to upgrade and rearrange the public switched network without concurrently considering ways of funding those costs. Third, placing the large costs of transition solely upon U S WEST, without giving it the means to recover those costs, disadvantages U S WEST from a financial perspective relative to its competitors. This translates into a competitive benefit to new entrants and a competitive detriment to U S WEST. In other words, this policy is pro-competitor (i.e., in this case denying U S WEST recovery, favors the new entrant) rather than pro-competition and, therefore, is not in the public interest. Finally, the Telecommunications Act anticipated and intended special recovery mechanisms for these costs outside of a rate-of-return proceeding, and, therefore, the ICAM proposal should be considered in this type of situation.

Although situations of abnormal costs are rare, they are not unknown in regulation. It is not uncommon under regulation for extraordinary events such as these to be handled outside of a general rate-of-return proceeding. Normally, a special amortization process is used that accelerates the recovery of these expenditures over a shortened time frame. This mechanism provides increased cash flow to help offset the extraordinary burden these expenditures have on the regulated utility. As discussed earlier, special amortizations and recovery mechanisms have been provided in many state and federal jurisdictions for fuel adjustment costs, extraordinary network improvement projects, competition driven implementation costs, and other events

deemed to be in the public interest. The EANR charge for costs incurred to implement competition in the long distance market is one example. Because U S WEST is in these special circumstances of implementing federal and state competitive mandates in short time frames and experiencing significant costs to enable competition in Minnesota, the Commission should approve the ICAM.

U S WEST estimates the costs of implementation of interconnection to be significant. Interconnection expenditures in Minnesota in 1996 were $2.5 million. Interconnection expenditures for 1997 through 1999 are estimated to be as high as $76.5 million for capital expenditures and $29.9 million for expense in Minnesota. These amounts as a percentage of annual construction in Minnesota are 18.5%. As a percentage of operating cash flow they are 9.6%. Extraordinary expenditures of this nature are not normal operating expenditures or general network upgrades.

f. ICAM Does Not Represent a "Blank Check."

AT&T alleges that ICAM represents nothing more than a "blank check" from competitors to fund U S WEST operations.[25] MCIm states that the U S WEST petition puts the "cart" of a cost recovery mechanism before the "horse" of proving that such costs should be recovered.[26] Frontier claims that the U S WEST petition is "based on speculation" since cost levels aren't specified.[27]

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[25] AT&T Comments, page 4.

[26] MCIm Comments, page 4.

[27] Frontier Comments, page 5.

These statements provide no basis for the rejection of this filing. While U S WEST has estimated the ICAM costs, it cannot know what the exact amount of extraordinary costs will be prior to the costs being incurred. Because estimates are just that--estimates--U S WEST is proposing a tracking mechanism that will track actually incurred costs as they are incurred. U S WEST is requesting a mechanism for the recovery of these actually incurred costs. U S WEST is not asking for the recovery of some estimate of future costs. This is a very reasonable proposal which allows for the recovery of actual, not speculative, costs.

3. Response to MIC.

MIC asserts that it is not clear whether the alternative cost recovery mechanism of a monthly surcharge on access lines would apply to access lines served by other local exchange carriers such as MIC members. To clarify, U S WEST proposes that the monthly surcharge apply only to facilities owned by U S WEST, but the surcharge would apply to all loops, regardless of whether the end user obtains service directly from U S WEST, or from a reseller, or a CLEC providing service over unbundled loops.

Respectfully submitted,

Dated: March 6, 1997

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Exhibit 1